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Recent farm-debt problems have received much attention in the press, in Congress, and in state legislatures. Farm auctions, bankrupt machinery dealers, bank closings, and cracks in the Farm Credit System are signs of financial stress. A wringing-out of 10 percent or more of all farmers in the next several years is widely predicted, and Ohio will be a representative player in this grim game (USDA). While Ohio has 86 thousand farmers, only a quarter of them, 22 thousand, are commercial farmers. Of these commercial units, about 10 percent had serious problems with debt/asset rations above .7, and nearly 20 percent had ratios of .4 to .7 in 1985 (Lee). Some 6,400 commercial farmers in Ohio were experiencing significant financial tension in early 1985, and about $1 billion was owed by farmers who are technically insolvent. Of all Ohio farmers, three percent (2,700) were involved in legal actions on delinquent loans in late 1985.

Farmers and their representatives have been aggressive in seeking government assistance with these problems. Nationally, an emergency Farm Credit System Bill was passed by Congress in December 1985 and adjustments in Farmers' Home Administration authorizations in the 1985 Farm Bill were responses to these pressures. At least five state initiatives have also emerged: state loan guarantees, foreclosure moratorium, low interest rate loans, interest rate buy-downs or deferral programs, and use of linked state deposits (LDP) for agricultural loans (Popovich). In terms of dollar commitments, the linked-deposit programs are the most important with Indiana, Kansas, Michigan, Missouri, and Ohio involved. Two large linked-deposit efforts are in Michigan with $139 million authorized and in Ohio with $100 million. The operation of the linked-deposit program (LDP) in Ohio illustrates the strengths and weaknesses of this approach.

Linked-Deposits in Ohio

In early April 1985 the General Assembly (the state legislature) authorized the Treasurer to use $100 million in a LDP for agricultural loans. The explanation given for LDP was: "The General Assembly finds that there exists . . . an inadequate supply of agricultural credit . . . at affordable interest rates . . . which makes it difficult for persons to get into agriculture or for persons in agriculture to continue operations . . ." (116th General Assembly Conference Committee Report on H.B. No. 344, p. 10). LDP funds can be used to purchase time certificates in qualifying financial institutions until July 1, 1987 of up to 24 months duration. Thus, the Treasurer may roll the $100 million through three cycles of lending: 1985, 1986, and 1987. In addition, a loan-size ceiling of $100 thousand was set, lenders were asked to stress operating loans, and any commercial bank, production credit association (PCA), or federal land bank in Ohio can participate.

In 1985 lenders were required only to send the State Treasurer a short form for each loan applicant. The Treasurer then purchased approximately 300 bank time certificates for the value and term of the approved loans. These certificates earned an interest payment 4 percentage points less than the market rate, with the lender passing the interest savings on to LDP borrowers. The lender assumed all loan recovery risk. To allow PCAs to participate, the Treasurer bought a single Farm Credit System debenture for $50 million to initiate LDP with PCAs. Money committed to PCA borrowers again earned 4 percentage points less than the market rate, while the state received market rates of interest on the remaining, uncommitted debenture balance.

By the third week of June 1985 only ten weeks after the program was authorized, the entire $100 million was committed in the first cycle to 1,575 agricultural loans made by 92 banks or PCAs throughout the state (Report to State Treasurer). Commercial banks and PCAs each made about half of the number and value of loans authorized under the program, with five PCAs lending one-third of all LDP loans. The size of loans ranged from two thousand dollars to the maximum of $100 thousand, the average size being $63 thousand. Almost one-third of the loans were for the maximum amount allowed. LDP reached farmers in 82 of Ohio's 88 counties and 93 percent of the loan value authorized was for a term of under one year. Less than five percent (83) of the 1,770 loan applications submitted to the State Treasurer were rejected because the applicants' debt/equity ratios were below .25, because their interest/total expenses ratios were less than .10 for the past three years, or because they were not full-time farmers.

Who Received the Loans?

In the first cycle of LDP (1985) 2 percent of all farmers in

Ohio--7 percent of the commercial farmers--received loans under the program. Lenders promoted LDP among their clients in various ways. A few lenders extended LDP loans to all of their farmer borrowers, other lenders did not advertise LDP loans and gave them only to farmers who asked for them, other lenders chose not to participate in LDP because they did not want to appear to play favorites, a few lenders gave LDP loans to their borrowers who most needed them, and still other lenders appear to have given the cheap loans to a random sample of their farmer borrowers. In a few cases lenders mentioned using the lure of an LDP loan to retain a client who might otherwise have switched to another lender. This appears to have been common in several PCAs that were struggling to maintain their market share. Clearly, the PCAs would have lost numerous clients if special arrangements had not been made for PCAs to participate in LDP.

Initially, I attempted to get 1985 data from the State Treasurer's Office in order to compare debt/equity ratios of LDP participants with similar ratios for all farmer borrowers in financial institutions participating in LDP. Unfortunately, I was unable to get access to the State Treasurer's information. My impressions of the characteristics of borrowers who received LDP loans, as a result, are drawn from informal conversations with lenders who participated in LDP. These discussions led me to four conclusions: first, virtually all LDP borrowers could have gotten a loan from their lender without LDP. Second, lenders feel that all of the LDP borrowers were creditworthy. Third, in the minds of the lenders, no LDP borrower was switched from being a poor credit risk to being creditworthy through having access to the cheaper LDP loans. And, fourth, lenders did not systematically direct LDP loans to those borrowers in their portfolio who were most financially stressed.

Analysis of the Program

The LDP should be evaluated using the objectives stated in the bill authorizing its funding: to augment the amount of loanable funds available for farmers in Ohio, and to assist those in financial stress or those trying to get into farming. This requires answering two questions: Did LDP result in an increase in agricultural lending in Ohio? And, did new farmers and farmers experiencing financial stress receive LDP loans?

Answering the supply-augmentation question is complicated by fungibility and counterfactual problems; units of money are interchangeable or fungible for each other. Thus, a lender, or a borrower, may substitute LDP funds for their own money or for funds they might have borrowed from other sources. A PCA, for example, can easily substitute LDP funds for money that it might otherwise borrow from the New York Bond Market via the Farm Credit System. Likewise, a commercial bank can easily substitute LDP funds for deposits that might, otherwise, be lent to farmers and divert the released deposits to investments in, say, U.S. Treasury bills. In either case, LDP would not augment the amount of loans made to farmers over what would have occurred without the program.

The counterfactual problem is more vexing. One does not know what the actions of lenders and borrowers would have been without

LDP. Would financial intermediaries have made loans to most of the LDP participants without the program, and would the total volume of agricultural loans in Ohio have been about the same without LDP? These questions must be addressed obliquely for insights into what would have happened without LDP.

For the past several years the total volume of agricultural credit in Ohio has contracted. Likewise, the loan/deposit ratios for most banks making agricultural loans have also declined because farmers' creditworthiness has withered, farmers have reduced their debt, and borrowers have requested fewer and smaller loans because of low rates of return in agriculture. It is clear, nevertheless, that if farmers become more creditworthy the PCAs and commercial banks can easily obtain additional funds for farm lending from money markets or from their own deposits and assets. Informal discussions with about a dozen agricultural lenders in the state have led me to conclude that LDP did not add to the amount of money they would otherwise have lent to farmers. LDP substituted for other funds and, thus, had little effect on the supply of agricultural credit available in Ohio during 1985.

If the supply-augmenting impact of LDP has been negligible, then the income transfer resulting from the concessionary interest rate on the deposits and loans is LDP's most significant feature. Ignoring the small additional transactions costs incurred by the General Assembly in passing the enabling bill and by the Office of the Treasury in implementing the program ($25,000 additional was authorized by the of the maximum LDP amount of $100 thousand for two years receive an interest rate subsidy of $8,000, while the LDP's smallest borrower of $2,000 for nine months only receives a subsidy of $60. Since only one-third of the LDP borrowers received 50 percent of the total loan value in 1985, they also received half of the total subsidy, assuming the average length of term of loans across loan-size groups is approximately equal. Thus, the benefits of the LDP subsidy are concentrated when compared to all Ohio farmers and they are also concentrated when only the beneficiaries of LDP are analyzed.

Comprehensive information is not available to compare LDP borrowers with other individuals borrowing from participating lenders, but a few general characteristics of LDP participants can be noted. Most importantly, to qualify for an LDP loan one must first be judged creditworthy by the individual lender. Since lenders assume recovery risks of LDP loans, lenders select LDP borrowers from the pool of individuals that the lender would be willing to lend to with or without LDP. Those who are insolvent, poor credit risks, or self financed are not in that pool. Also, when lenders are reducing their farm loans, it is difficult for new borrowers to obtain loans. To get into the LDP program, therefore, an individual must have a healthy income and asset situation, and also have had a working relationship with the lender. It is unlikely that a significant number of the 6,400 farmers in Ohio with debt/asset ratios in excess of .4 participated in LDP. Certainly, none of the 2,700 who are legally insolvent benefited from the program.

All those who receive loans at concessionary interest rates benefit from the cheap credit. But, the effectiveness of interest rate subsidies are relative to the size of the problem doctored, and the treatment should be large enough to significantly affect borrowers' financial viability or access to farming. For example, two aspirins may relieve a normal headache, but have no effect on the pain from a broken back; one aspirin may relieve the headache of a child, but do nothing to dull an adult's migraine. Unfortunately, most of the farmers with migraines in Ohio will experience little relief from LDP because they were excluded from the program. Even if they could participate, the subsidy was too small for their pains. If, as estimated, there is $1 billion in bad farm debt in Ohio, the state's three-year $9 million subsidy involved in LDP will not cover even one-tenth of the interest payment on this debt for one year.

Conclusions

LDP has three favorable features. First, it demonstrated that the General Assembly cared about the problems faced by farmers in Ohio and tried to ease these difficulties. Second, the Office of Treasurer carried out the program quickly, imposed few loan transactions costs on lenders or borrowers, and was helpful in answering questions about the program. Third, LDP will give an interest rate break on loans to several thousand farmers in Ohio. All of these borrowers are slightly better off financially than they would have been if they had paid market rates of interest.

At the same time, LDP has shortcomings. It is unlikely, for example, that LDP augmented the amount of money lent to farmers in

Ohio; most of the LDP borrowers would have received similar sized loans without LDP. Also, the concessionary interest rates were not a significant factor in altering the creditworthiness of potential borrowers. LDP likely resulted in the PCAs drawing fewer funds from the New York Bond Market and allowed commercial banks to invest more of their deposits in non-loan assets.

It also appears that most of the benefits from concessionary interest rates on LDP loans went to individuals who were already farmers and whose financial conditions allowed them to qualify for loans, regardless of LDP. Since only a few farmers in the state got LDP loans, the benefits from LDP were highly concentrated among farmers who were better off than the farmers who were not creditworthy. This raises questions about the equitability of the program.

Another cost of LDP is in "shooting one's political wad." The marginal political capital that groups expend each time they return to the political arena generally increases. That is, it may have been relatively easy for farmers and their representatives to get LDP from the General Assembly, but each succeeding effort to get assistance encounters diminishing political returns. It is common for any elected body to shift its concerns to other matters once a public program is established to address a problem, even if the program does not resolve the problem.

What are the lessons that might be learned from LDP? Most importantly, it demonstrates the severe limitations any credit program has in addressing agricultural problems. Credit programs are easy to start, but their impact is nearly impossible to control because of fungibility. Also, subsidies tied to loans often fail to reach the desired target group and the effect of the subsidy is almost always regressive on income distributions (Adams and others). Concessionary credit programs are of little help to those experiencing extreme financial stress.

How might the state subsidy in Ohio have been more effectively targeted? It may have been possible, for example, for the General Assembly to place $9 million into a lottery for all those in the state who were losing their farms or who wanted to enter farming. The first 200 lucky people drawn from the pool could have received a $45 thousand grant each to pay off part of their debts. Or, $9 million could have been given to one or several agencies to help bankrupt farmers and their families seek other employment. Or, the state could have used the money to buy some of the distressed farm land for parks and hunting reserves from farmers who want to partially liquidate their holdings and ease their debt positions. This would have increased farm land values and thus benefited all farmers in the areas of the purchases.

It's unfortunate that the difficulties currently experienced by U.S. farmers are mostly labeled as debt problems; financial stress is a symptom rather than a cause of an economic fever. Low farm prices, bad luck, declining land values, excessively liberal lending practices in the past, and weak farm management have caused this fever. While emergency credit programs may temper the fever, they do not attack its roots. Efforts such as Ohio's LDP offer little help for those who are most stressed, allocate benefits mostly to those who don't need it, and grant benefits too small to provide a significant amount of relief.

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General Assembly for the Treasurer), the main cost of LDP has been the opportunity costs of state funds allocated to LDP due to the concessionary interest rates. If all of the $100 million LDP funds are fully committed for three of the four years possible, the subsidy will be $12 million (.04 x $100 million x 3). If the funds are fully committed at concessionary rates for only the equivalent of nine months in each of the three years the subsidy will come to $9 million, a more probable figure. All citizens of Ohio bear the cost of this subsidy. As an aside, this subsidy is small compared to the $100 million plus spent by the state to make whole the depositors in Home State Savings Bank in the Spring of 1985.

While the amount of the LDP subsidy was small, it is important to know the extent to which it reached the needy, and whether or not the subsidy received was large enough to make a difference. Fortunately, subsidies tied to concessionary interest rates are easy to measure. The subsidy is always proportional to the size of loan: no loan no subsidy, small loan small subsidy, large loan large subsidy. Also, the longer the term of the loan, the larger the subsidy. Since loan size, assets, and income of borrowers are positively correlated, interest rate concessions allocate subsidies regressively. Because only 2-4 percent of all farmers in Ohio will likely receive a concessionary priced LDP loan--depending on how many new borrowers participate in cycles two and three of LDP--at least 95 percent of Ohio's farmers will not benefit from LDP. At most, LDP will reach only 10-15 percent of the 22 thousand commercial farmers in Ohio. Borrowers